Supreme Court, U. S.
FILED
SEP 2 - 1980
MICHAEL RODAK, JR., CLERK

No. 80-338

IN THE

Supreme Court of the United States

October Term, 1980.

HCSC-LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

NORMAN A. PEIL, JR.,
PEIL & EGAN, P. C.,
Alpha Building,
Easton, PA
Counsel for Petitioners.

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

QUESTION PRESENTED FOR REVIEW.

Did the Congress of the United States, in enacting section 501(e) of the Internal Revenue Code, which specifically permits joint hospital facilities performing specified services to be treated as tax-exempt charitable organizations under section 501(c)(3) of the Code, intend to preclude joint hospital facilities performing services not specifically included in section 501(e) from qualifying as tax-exempt charitable organizations under section 501 (c)(3)?

TABLE OF CONTENTS.

	Page
QUESTION PRESENTED FOR REVIEW	i
OPINIONS BELOW	1
JURISDICTION	2
STATUTES AND REGULATIONS INVOLVED	2
STATEMENT OF THE CASE	5
ARGUMENT	7
CONCLUSION	13
APENDIX:	
Opinion of the United States Court of Appeals for the Third Circuit by Sloviter, Circuit Judge	A1
Judgment of the United States Court of Appeals for the Third Circuit	A20
Opinion and Order of the United States District Court for the Eastern District of Pennsylvania, E. Mac Troutman, Judge	A22

TABLE OF CITATIONS.

Cases: Page

Associated Hospital Services, Inc. v. Commissioner, 74 T. C. — (No. 17) (1980) 8

Chart, Inc. v. United States, 45 AFTR 2d 80-555 (1980) on appeal to the Court of Appeals for the District of Columbia 10

Community Hospital Services, Inc. v. United States, 43 AFTR 2d 79-934 (E. D. Mich., 1979) on appeal to the Sixth Circuit (No. 79-1286) and the District Court for the Eastern District of Pennsylvania in the instant case, 473 F. Supp. 250 ..... 7, 8

Hospital Central Services Association v. United States, 40 AFTR 2d 77-5646 (W. D. Wash., 1977) reversed — F. 2d — No. 77-3701) (C. A. 9, July 21, 1980) 7

Metropolitan Detroit Area Hospital Services, Inc. v. United States, 445 F. Supp. 857 (E. D. Mich., 1978) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1205 and 78-1218) 7, 10

Northern California Central Services, Inc. v. United States, 591 F. 2d 620 (1979) 8

United Hospital Services, Inc. v. United States, 384 F. Supp. 776 (S. D. Ind., 1974) 7

Va. Professional Standard Review Foundation v. Blumenthal, (D. C. D. C. 446 F. Supp. 1164 (1979)) 12

Statutes and Regulations:

Internal Revenue Code of 1954 (Title 26 United States Code):

Section 501(a) 3, 4, 5

Section 501(c)(3) .....i, 2, 3, 4, 5, 7, 8

Section 501(e) .....i, 3, 7, 8

Judicial Code (Title 28 United States Code):

Section 1254(1) 2

Section 1346 6

Regulations 1.501(c)(3)-1(d)(2) 4

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980.

No. .

HCSC-LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

HCSC-Laundry, a Pennsylvania non-profit corporation, by its attorneys, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered June 6, 1980.

OPINIONS BELOW.

The Memorandum and Order of the District Court for the Eastern District of Pennsylvania dated July 10, 1979 is printed at pages A22 to A32, *infra*, and reported at

473 F. Supp. 250. The opinion of the United States Court of Appeals for the Third Circuit reversing the District Court filed June 6, 1980 (No. 79-2286), is printed at pages A1 to A19, *infra*, and reported at — F. 2d —. The judgment of the Court of Appeals entered June 6, 1980 is printed at page A20, *infra*, and not officially reported.

JURISDICTION.

The judgment sought to be reviewed is dated June 6, 1980 which is also the date of its entry. The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code, Title 28 U. S. C. 1254(1).

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code of 1954, Title 26 United States Code, Section 501 the pertinent portions of which are as follows:

> § 501. Exemption from tax on corporations, certain trusts, etc.
>
> (a) Exemption from taxation—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.
>
> * * *
>
> (c) List of exempt organizations—The following organizations are referred to in subsection (a):
>
> * * *
>
> (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing

for public safety, literary, or education purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations —For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

Regulations Section 1.501(c)(3)-1(d)(2).

(a) *Charitable defined.* The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions.

STATEMENT OF THE CASE.

The facts in the case were fully stipulated and are not in issue. Petitioner, HCSC-Laundry, was incorporated in 1967 under the Pennsylvania Non-Profit Corporation Law to provide laundry and linen service to fifteen non-profit hospitals and a small ambulance service all located in Eastern Pennsylvania. All of the organizations served have received federal income tax exemptions under Section 501(c)(3) of the Internal Revenue Code. Each participating hospital pays dues based upon its bed capacity. Petitioner's purpose, as set forth in its Articles of Incorporation, is to (a) operate and maintain a hospital laundry and linen supply program for those public hospitals and non-profit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with it, (b) to cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes, and (c) to accomplish the foregoing purposes in a manner consistent with the provisions of Section 501(c)(3) of the Internal Revenue Code of 1954. Under its by-laws, none of its profits may be distributed other than to hospital members. No part of its earnings may inure or have inured to the benefit of any individual or profit-making corporation. Petitioner's facilities provide sanitary and quality standards not always available from commercial laundries.

Petitioner was formed following an investigation into the various ways in which laundry service could be provided to area hospitals upon the recommendation of the Lehigh Valley Health Planning Council, an agency under the Hill-Burton Act, which had received numerous requests from area hospitals to approve funds to modernize their respective in-plant laundry facilities. The Council

investigated and considered alternate sources of laundry sources available to area hospitals. Among the options the council considered were individual hospital laundries, commercial off-premises facilities, joint facilities with a single hospital laundry providing services to one or more hospitals beside itself, and shared non-profit, off-premises laundries which service several non-profit hospitals. A joint service was rejected because no hospital in the area had sufficient laundry facilities to serve more than itself. A large commercial laundry contacted was not interested in handling the full volume of laundry business of all the hospitals involved, and most of the other available commercial laundries were considered incapable of handling the heavy volume. The council concluded that a shared non-profit-off-premises laundry would best accommodate the requirements of the member hospitals both from the viewpoint of quality of service and economies of scale.

In addition to nominal dues, Petitioner's only other income is received from charges to its members for laundry and linen service furnished based upon budgeted cost plus a charge of 1½¢ per pound for funding equipment replacement and acquisition. The "profit" which the United States, through the Internal Revenue Service, seeks to tax is represented by the difference between the debt amortization included in the cost figure and the depreciation allowable on the assets acquired with such debt plus the 1½¢ per pound charge.

Jurisdiction over this matter is conferred upon the United States District Court by Title 28, United States Code, section 1346.

ARGUMENT.

The decision of the Court of Appeals for the Third Circuit, to which this petition is addressed, is contrary to the holding of every other federal court on the question involved save only the United States Tax Court. (Subsequent to the Third Circuit's decision, its position was followed by the Ninth Circuit in a per curiam decision rendered July 21, 1980 and cited below.) The Tax Court decision was based on the argument that organizations of the type which Petitioner represents are feeder organizations under Section 502 of the Internal Revenue Code, a position which has been uniformly rejected by the other federal courts that have had occasion to consider the question. Indeed, in the instant case, this argument was made by the government in the District Court but was abandoned on appeal and the Third Circuit decided the question solely on the basis of whether Congress, by enacting Section 501(e) of the Internal Revenue Code, (relating to specified cooperative hospital services) and that section's legislative history, automatically precluded an organization which provides cooperative hospital services not specified in Section 501(e), such as Petitioner, from qualifying as a tax-exempt organization under Section 501(c)(3).

The government's legislative history argument was made unsuccessfully to five District Courts, namely, *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (S. D. Ind., 1974), *Hospital Central Services Association v. United States,* 40 AFTR 2d 77-5646 (W. D. Wash., 1977) reversed — F. 2d — (No. 77-3701) (C. A. 9, July 21, 1980), *Metropolitan Detroit Area Hospital Services, Inc. v. United States,* 445 F. Supp. 857 (E. D. Mich., 1978) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1205 and 78-1218), *Community*

Hospital Services, Inc. v. United States, 43 AFTR 2d 79-934 (E. D. Mich., 1979) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1286) and the District Court for the Eastern District of Pennsylvania in the instant case, 473 F. Supp. 250. Counsel has also been informed that the decision of the United States Tax Court in *Associated Hospital Services, Inc. v. Commissioner,* 74 T. C. — (No. 17), (1980) is being appealed to the Court of Appeals for the Fifth Circuit. Aligned with this array of consistent decisions by the United States District Courts is a decision in December, 1979 by the United States Court of Claims, a court of co-equal rank with that of the Third Circuit, *Northern California Central Services, Inc. v. United States,* 591 F. 2d 620 (1979).

At oral argument in the Third Circuit, government counsel agreed that the facts of the instant case are for all relevant purposes the same as those of the predecessor cases cited above.

The narrow issue to be resolved is whether the legislative history underlying the enactment of Section 501(e) indicated an intention by Congress to preclude a joint hospital service organization not enumerated in that section from qualifying for federal income tax exemption under Section 501(c)(3). That the legislative history does not clearly deal with the issue is obvious from the sharply divergent views regarding the conclusion to be drawn from that history reached in the decisions cited above and can be summarized by the following extracts from the decisions of the United States Court of Claims and the Third Circuit.

The Court of Claims in *Northern California Central Services, Inc., supra,* summarized its conclusion on this issue as follows: (pps. 623 and 624)

> "Defendant's brief details legislative history indicating that Congress had long considered granting ex-

emptions to shared laundry services under § 501(e) and eventually decided against such an action. This, counsel for the government concludes, demonstrates that Congress deliberately foreclosed opportunities for shared laundry services to obtain an exemption under any other provision of § 501, including § 501 (c)(3). * * * It is, we suppose, arguable that Congress preempted the subject of hospital laundries in passing § 501(e), and by not mentioning them with other hospital services it did mention, carved them out of § 501(c)(3). Our consideration of the legislative history of § 501(e) does not lead us to this sweeping conclusion. Section 501(e) provides an exemption for some cooperative organizations which adhere to the requirements stated therein. We agree with plaintiff that the intent of Congress in passing § 501(e) was to broaden the class of organizations entitled to an exemption as a 'charitable organization' not to narrow it, and that, as to laundry services, it left the law as it was.

"In considering § 501(e)'s history, it is necessary to examine not only what Congress did do in 1968 when it added that provision, but what it did not do.***"

In direct contrast with this analysis and conclusion is the statement of the Court of Appeals for the Third Circuit in the instant case at page 17 of the slip opinion as follows:

"***As noted in our prior discussion, we believe the legislative history to show a contrary legislative intent than that found by the Court of Claims. We believe that it demonstrates that Congress recognized that hospital service organizations were not heretofore considered within Section 501(c), or that their

> inclusion within that section was questionable. In order to clarify its position, Congress enacted Section 501(e) to specify that certain types of hospital service organizations shall be considered as charitable organizations. If they had already been within Section 501(c), the enactment of Section 501(e) would have been a totally superfluous undertaking by Congress, an anomalous result which we cannot attribute to it. [footnote omitted]"

As to this argument, see contra the holding of the United States District Court for the District of Columbia in *Chart, Inc. v. United States,* 45 AFTR 2d 80-555 (1980) on appeal to the Court of Appeals for the District of Columbia.

In summary, as the matter now stands, every district court which has considered the matter has held in favor of the Petitioner's position, the United States Tax Court with four dissents and on a completely different legal theory not espoused by the government in this case has held for the government, the Court of Claims has held for the Petitioner's position and, a court of co-equal rank, the Court of Appeals for the Third Circuit, recently supported by the Court of Appeals for the Ninth Circuit, has held for the government. Appeals in similar cases are pending in the Fifth and Sixth Circuits and the Court of Appeals for the District of Columbia. (It is counsel's understanding that the *Metropolitan Detroit Area* case *supra,* has been argued to the Sixth Circuit but not decided.) Clearly this sharp split between the various federal courts including those of co-equal rank renders impossible the uniform administration of the tax laws throughout the country. Thus, the situation presents a classic basis for review of the Third Circuit's decision by this Court under its Rule 17(a).

Furthermore, Petitioner believes that there is an additional and compelling reason why this Court should accept its Petition for Certiorari. This case involves more than merely the tax-exempt status of an isolated taxpayer. Rather, it represents a challenge to the tax status of numerous similarly situated cooperative hospital service laundries throughout the United States. The principal motivation for organization of such joint laundries was the control over sanitary standards necessary to efficient hospital operations and the attempt to contain this aspect of hospital costs through the economies of scale. This approach is in recognition of the conclusions reached in numerous studies by various Health Planning Councils, agencies created under the Hill-Burton Act, 42 U. S. C. § 291. A survey of the 36 known hospital joint service laundries such as Petitioner from which 26 replies were received indicates that there are well over 175 hospitals throughout the United States served by such hospital joint service laundries. Furthermore, the amount of the taxes involved, and therefore the ultimate effect on hospital costs, is not insignificant. The same survey indicates that there is presently pending in the courts or subject to future determination through the most recently-ended fiscal years of the organization's potential federal income taxes of over $2,700,000 which, of course, will continue to accrue year after year if the law is as interpreted by the Third Circuit. These taxes will, of necessity, be passed on to the member hospitals in the form of higher laundry costs and, inevitably, to the patient in higher hospital charges.

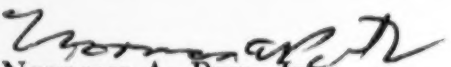
Ironically, the result reached by the Third Circuit is diametrically opposed to the ongoing efforts of the federal government to contain and control hospital costs. Thus, in an attempt to limit the amount of Medicare reimbursement to hospitals for legitimate expenses, the former De-

partment of Health, Education and Welfare mandated that hospitals act as "prudent and cost-conscious buyers" seeking to minimize the costs of goods and services. Provider Reimbursement Manual (P. R. M.) HIM-10 Part L § 2103. (The Manual is based upon 20 C. F. R. 405.451(c)(2)(ii) and 40 Fed. Reg. 51,474 and 51,975 (1975)).

The Department of Health, Education and Welfare's encouragement of shared service arrangements to contain costs is consistent with the intent of Congress as expressed in 42 U. S. C. § 300k-2. In that section Congress found that shared services deserved "priority consideration in the formulation of national health planning goals and in the development and operation of Federal State and Health area planning and resources development programs." It identified as such a goal: the development of multi-institutional arrangements for the sharing of support services necessary to all health service institutions. Shared laundry services, such as those involved in this case, are an essential part of the cost containment effort favored by Congress. See, *Va. Professional Standard Review Foundation v. Blumenthal,* (D. C. D. C. 446 F. Supp. 1164 (1979)).

CONCLUSION.

It is respectfully submitted that this Court should grant certiorari to resolve the conflict between the decision of the Court of Appeals for the Third Circuit and that of the Court of Claims in the interests of the uniform administration of the tax laws throughout the country and further in the interests of determining the federal income tax status of shared service laundry organizations in light of the Department of Health, Education and Welfare's emphasis on shared hospital service facilities for cost containment purposes.



NORMAN A. PEIL, JR.,
PEIL & EGAN, P. C.,
Counsel for Petitioner.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2286

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA,
Appellant

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
(D. C. Civil No. 78-1409)

Argued February 21, 1980
Before: ROSENN, SLOVITER, *Circuit Judges* and
LAYTON, *District Judge* *
(Opinion filed June 6, 1980)

M. CARR FERGUSON,
Assistant Attorney General
GILBERT E. ANDREWS
LEONARD J. HENZKE, JR.
DAVID ENGLISH CARMACK (Argued)
Tax Division
Department of Justice
Washington, D. C. 20530

Of Counsel:
PETER F. VAIRA
United States Attorney
Attorneys for Appellant

* Honorable Caleb R. Layton, III, United States District Judge for the District of Delaware, sitting by designation.

NORMAN A. PEIL, JR. (Argued)
MICHAEL J. EGAN
PEIL & EGAN, P. C.
Alpha Building
P. O. Box 351
Easton, Pa. 18042
Attorneys for Appellee

STEPHEN JOHN FELLMAN
HENRY ASHTON HART
LOOMIS, OWEN, FELLMAN & HOWE
2020 K Street, N. W., Suite 800
Washington, D. C. 20006

Attorneys for Amicus Curiae
Textile Rental Services
Association of America

THOMAS C. BRICKLE
1050 17th Street, N. W., Suite 500
Washington, D. C. 20036

Attorneys for Amicus Curiae
International Fabricare
Institute

OPINION OF THE COURT

SLOVITER, *Circuit Judge.*

I.

On this appeal by the IRS from summary judgment entered against it, we must decide whether Congress, in enacting section 501(e) of the Internal Revenue Code, which specifically permits joint hospital facilities performing specified services to be treated as tax exempt charitable organizations under section 501(c)(3) of the

Code, intended that joint hospital facilities performing services not specifically included in section 501(e) could nevertheless be treated as tax exempt charitable organizations under section 501(c)(3).

II.

Plaintiff HCSC-Laundry, a non-profit corporation with its principal office in Allentown, Pennsylvania, was incorporated under the Pennsylvania Nonprofit Corporation Law on January 3, 1967.[1] It provides laundry and linen service to fifteen non-profit hospitals located in the Greater Lehigh Valley, Reading, Scranton, and suburban Philadelphia, Pennsylvania, and to the Cetronia Ambulance Corps, which serves a village adjacent to Allentown, Pennsylvania. All the hospitals and the ambulance corps have received federal income tax exemptions under section 501(c)(3) of the Internal Revenue Code.

The formation of HCSC-Laundry followed an investigation into the various possible ways in which laundry service could be provided to the area hospitals. In early 1966 the Lehigh Valley and Health Planning Council,

---

1. Its purpose, as set forth in its Articles of Incorporation, as amended May 29, 1970, is:

A. To operate and maintain a hospital laundry and linen supply program for those public hospitals and non-profit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with this corporation.

B. To cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes.

C. To accomplish the foregoing purposes in a manner consistent with the provisions of Section 501(c)(3) of the Internal Revenue Code of 1954.

an agency under the Hill-Burton Act,[2] received requests from some of the area hospitals to approve funds requested to modernize their hospitals' in-plant laundries. The Council investigated and considered alternate sources of laundry services available to area hospitals. Among the options the Council considered were individual hospital laundries, commercial off-premises facilities, joint facilities with a single hospital laundry providing services to one or more hospitals beside itself, and shared nonprofit, off-premises laundries which service several nonprofit hospitals. A joint service was rejected because no hospital in the area had sufficient laundry facilities to

2. The Hill-Burton Act, a funding statute, was enacted, *inter alia*, to assist the states in carrying out programs for construction and modernization of "such public or other nonprofit community hospitals and other medical facilities as may be necessary, in conjunction with existing facilities, to furnish adequate hospital, clinic or similar services," 42 U. S. C. § 291. In order to participate in the program, states have to submit comprehensive plans designating "a single State agency as the sole agency for the administration of the plan, or designat[ing] such agency as the sole agency for supervising the administration of the plan," 42 U. S. C. § 291d(a)(1), as well as indicating the existing facilities, the needs within the state and a construction and modernization program which will meet those needs. 42 U. S. C. § 291d(a). A 1964 amendment emphasized the need for comprehensive planning in metropolitan and local areas. The Hospital and Medical Facilities Amendments of 1964, Pub. L. 88-443, § 2, 78 Stat. 447, added new section 318 to the Public Health Service Act, 42 U. S. C. §§ 201 *et seq.*, which authorized expenditure of funds over the following five year period for grants to state agencies chosen in accordance with 42 U. S. C. § 291d(a)(1) to cover part of the costs of "projects for developing (and from time to time revising) and supervising and assisting in the carrying out of comprehensive regional, metropolitan area, or other local area plans for coordination of existing and planned health facilities, and facilities related thereto, and services provided by such facilities." *See generally* Comment, *Comprehensive Health Planning—Federal, State, Local: Concepts and Realities*, 1970 Wis. L. Rev. 838, 843-46.

service more than itself. A commercial laundry contacted was not interested in handling the full volume of laundry business of all the hospitals involved, and most of the other available commercial laundries were considered incapable of handling the heavy volume. The Council concluded that a shared non-profit, off-premises laundry would best accommodate the requirements of the member hospitals both from the viewpoint of quality of the service and economies of scale. Accordingly, HCSC-Laundry was formed.[3] Its laundry plant was built and equipped at a cost of approximately 2 million dollars, which it secured from local banks by using as collateral fifteen year contracts from 10 area hospitals. It employs approximately 125 people.

The corporation has no capital stock. Each participating hospital is a dues-paying member of the corporation. HCSC dues were $500 for the taxable year in issue. Centronia Ambulance Corps does not pay dues in order to receive laundry service. HCSC-Laundry's only income in addition to the dues is a laundry charge of 1½¢ per pound of laundry serviced which is charged to each customer over the actual cost. "Cost" for this purpose includes operating expenses, debt retirement, and linen replacement. This charge in excess of cost is placed in a fund for equipment replacement and acquisition.

HCSC-Laundry sought exemption from federal income tax and, on March 26, 1976, filed an Application for Recognition of Exemption (Internal Revenue Service Form 1023) under Section 501(c)(3) of the Internal Revenue Code. This section authorizes exemption for corporations "organized and operated exclusively for religious, charitable, scientific, or . . . educational purposes . . . no part of the net earnings of which inures to the benefit of

3. Taxpayer was originally named Hospital Central Services Corporation. Its name was changed in 1970.

any private shareholder or individual . . . ." I. R. C. § 501 (c)(3).[4] It is stipulated that plaintiff has never made a

4. Section 501 provides in pertinent part:

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) List of exempt organizations—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from tax-

distribution of money or property nor have any net earnings inured to the benefit of any member or individual.

4. (Cont'd.)

ation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

The IRS denied the application stating:

> Section 501(e) of the Code provides for exemption from Federal income tax of certain hospital service organizations organized and operated solely to perform specified services for member hospitals. Section 501(e)(I)(a)[sic] of the Code lists the specified services as data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training and education of personnel) services.
>
> Since laundry services are not one of the services specified in section 501(e)(I)(a)[sic], the organization does not meet the requirements of section 501(e) of the Code, and thus is not exempt from Federal income tax under Section 501(c)(3). See Rev. Rul. 69-160 C. B. 1969-I, 147. Also see Rev. Rul. 69-633.

On December 16, 1976, HCSC-Laundry filed a federal corporate income tax return (form 1120) for the fiscal year ending June 30, 1976 indicating taxable income of $123,521.00 on which a federal income tax of $10,395.00 was paid. Promptly thereafter, it filed a Claim for Refund for overpaid federal income tax in the full amount paid, asserting it was "a tax-exempt organization under sections 501(c)(3) and/or 501(e) of the Internal Revenue Code of 1954." Although the IRS has informally advised HCSC-Laundry that the claim for the refund of taxes will be rejected, it has not taken formal action on this claim. This suit seeking a refund of the taxes paid followed.

The district court, on the basis of stipulated facts, entered summary judgment for HCSC-Laundry. *HCSC-Laundry v. United States,* 473 F. Supp. 250 (E. D. Pa.

1979). It held that despite the omission of laundry services from those particular services for hospitals which are exempted under section 501(e) of the Code, HCSC-Laundry was entitled to exemption as an organization described in section 501(c)(3) of the Code. The court concluded:

> The purpose of § 501(e) was to enlarge the category of charitable organizations exempt under § 501(c)(3), not to modify or narrow § 501(c)(3). Thus, it is improper to consider the addition of § 501(e) as causing to be excluded from § 501(c)(3) any organization that would have been included in § 501(c)(3) but for § 501(e), even if such organization was explicitly excluded from § 501(e) itself.

Id. at 253.

The court also rejected the IRS assertion that HCSC-Laundry was not entitled to a charitable exemption because it was a "feeder" organization under section 502(a) of the Code. That section provides that:

> An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

The court found that HCSC-Laundry was "a non-profit enterprise wholly controlled by charitable organizations 'in order to effect economies in their own operations'," 473 F. Supp. at 254, and determined that since HCSC-Laundry was an integral part of the hospitals, it was not a feeder organization under section 502(a) as clarified by the applicable Treasury Regulation on In-

come Tax, 26 C. F. R. § 1.502-1 (1979).[5] 473 F. Supp. at 254-55.[6] Therefore the court held HCSC-Laundry was

5. The relevant part of the regulation provides:

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations . . . .

26 C. F. R. § 1.502-1(b) (1979).

6. In a recent decision presenting a similar fact pattern where a Louisiana laundry service organization providing laundry service to four participating hospital members sought tax exemption, a divided Tax Court denied exemption on the ground that the organization was a feeder organization. Associated Hospital Services, Inc. v. Commissioner, 74 T. C. No. 17 (May 6, 1980). It reached that result by application of the "re-enactment doctrine" under which treasury regulations and interpretations which have continued over a long period of time without substantial change, and which apply to unamended or substantially reenacted statutes, are

exempt from taxation as an exempt organization under section 501(c)(3) of the Internal Revenue Code of 1954. *Id.* at 255.

III.

On appeal, the IRS argues that the legislative history indicates that section 501(e) is the exclusive method whereby a hospital service organization, such as HCSC-Laundry, is entitled to tax-exempt status. It asserts that the Congressional intent is clear that a hospital service organization performing laundry services is not entitled to tax exempt status. It is joined in this position by the Textile Rental Services Association of America and the International Fabricare Institute who have filed a brief amici curiae.

HCSC counters that the district court's construction holding it exempt is in accord with the applicable precedent. It contends that since the laundry performs on a joint basis the same hospital laundry activity which previously each of its members either performed individually as part of their tax-exempt activities or had performed for them by commercial laundries, the exemption should continue regardless of the form in which conducted, *i.e.*, jointly rather than separately.

IV.

It has been an accepted precept of statutory construction of tax laws, that a specific statute controls over a general one. *Bulova Watch Co. v. United States*, 365

6. (Cont'd.)

deemed to have received Congressional approval. See Helvering v. Winmill, 305 U. S. 79, 83 (1938). The Government has not appealed from the district court's disposition of this issue and it is therefore not before us.

U. S. 753, 758 (1961). In *Nitzberg v. Commissioner,* 580 F. 2d 357 (9th Cir. 1978), the appeal posed the problem of whether certain losses incurred in connection with the operation of gaming tables are to be treated as "ordinary and necessary expenses" deductible under I. R. C. § 162(a), or as "losses from wagering transactions", deductible only to the extent of gains from such transactions, under I. R. C. § 165(d). The court applied the foregoing precept and held the provision providing specifically for wagering losses governed. *See also State Mutual Life Assurance Co. v. Commissioner,* 246 F. 2d 319, 323 (1st Cir. 1957).

In the discussion of the application of this precept as an aspect of the *ejusdem generis* rule which appears in 1 J. Mertens, The Law of Federal Income Taxation § 3.16, at 34 (1974), it is noted that "this rule of ejusdem generis is not invariable and should not defeat the legislative intent deducible from the entire context." The statutory provisions at issue in this case would, under ordinary circumstances, warrant application of the rule of *ejusdem generis* since section 501(e) deals specifically with jointly operated hospital services. Therefore, unless the legislative history indicates a contrary legislative intent, section 501(e) should be considered controlling.

Before the 1969 amendments to the Internal Revenue Code which added section 501(e) to the statute, there was no provision of the Code specifically dealing with mutual entities establishd by tax exempt hospitals to supply them with certain services. The Internal Revenue Service took the position that if two or more tax exempt hospitals had joined together to create an entity to perform ordinary commercial services for them, the entity was not a tax exempt organization.[7]

7. See Rev. Rul. 54-305, 1954-2 C. B. 127.

In 1967 a Senate amendment would have treated organizations created by tax exempt hospitals to supply them with certain commercial services as charitable organizations. This amendment was not accepted by the House. H. R. Rep. No. 1030, 90th Cong., 1st Sess. 73 (1967). A House Report from the same session, directed to a bill which would have allowed Hill-Burton funds for cooperative hospital facilities regardless of their exempt status under the Internal Revenue Code, referred to the IRS interpretation that "an organization established by a number of other organizations to provide services or facilities for them, is not considered 'nonprofit,' even though the organizations for whom the services or facilities are provided are each non-profit." H. R. Rep. No. 538, 90th Cong., 1st Sess. 32 (1967).

The following year, Congress began work on the tax amendments which were to culminate in the enactment of section 501(e). The Senate proposed an amendment to the Tax Adjustment Bill of 1968 which would have treated as charitable organizations almost all entities established by tax exempt hospitals to provide commercial services, including laundry service. 114 Cong. Rec. 7516 (1968); 114 Cong. Rec. 8111-12 (1968). In the Conference Committee the House acceded only to a more limited scope for section 501(e). Under the version of 501(e) which emerged from the Conference Committee, certain specified service organizations were to be treated as "organized and operated exclusively for charitable purposes." Mutual laundry service organizations were not among the specified service organizations. However, the omission of laundry services was not inadvertent.

The Conference report specifically states:

> The new subsection does not grant tax-exempt status if the hospital service organization performs any

> services other than those specified in the new subsection (for example, laundry services), or performs any services for any person or organization other than a tax exempt hospital.

H. R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968).[8] It is further of interest that the then Acting Commissioner of the Internal Revenue wrote to the then Chief of Staff of the Joint Committee on Internal Revenue setting forth his understanding that "the cooperative laundry service itself would not be tax exempt."[9]

Although subsequent legislative history may not be as persuasive as contemporaneous history in indicating a Congressional intent, in the case of the interpretation of section 501(e) it also serves to demonstrate that the general understanding of those most directly affected, the hospitals, was that cooperative hospital laundries were

---

8. This interpretation was referred to again in the Conference Committee print on the 1968 statute which specifically noted that:

> The conferees agreed to the Senate provision, but limited it to a joint enterprise which is organized and operated *solely* to perform one or more of the following services for hospitals: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel. *Thus, an organization is not to qualify for exemption under this section if it performs any other services such as, for example, general laundry services* or performs any services for other than a tax-exempt hospital.

Committee of Conference on H. R. 15414, 90th Cong., 2d Sess., Revenue and Expenditure Control Act of 1968, Explanation of the Bill H. R. 15414, As Agreed to in Conference 20 (Comm. Print 1968) (emphasis added).

9. Letter from Lawrence N. Woodworth to James F. Dring (Feb. 10, 1969) *reprinted in* App. C to Brief for the Appellant at 58, adopted by letter from William H. Smith, Acting Commissioner, to Lawrence N. Woodworth (Feb. 16, 1969) *reprinted id.* at 62.

not entitled to obtain "charitable" status under the Code. Accordingly, in 1976 the American Hospital Association requested the Senate Finance Committee to extend tax exempt status to cooperative hospital organizations that performed laundry services. That statement included the following:

> Although not permitted under Section 501(e), central laundries to serve hospitals and other health care institutions are generally recognized as offering many benefits and advantages over individual hospital laundries, and over many commercial laundries that, if available at all, may not provide the type of quality of specialized service that hospitals require.

The statement continued:

> From the legislative history of Section 501(e) we understand that Congress intended to permit a comprehensive range of both administrative and clinical activities to be performed by 501(e) organizations, but to exclude laundry services.

Among the various recommendations made by the American Hospital Association was the following:

> That Section 501(e) of the Internal Revenue Code be amended to include "laundry services" among the activities cooperative hospitals services organizations may perform for their members.

Tax Reform Act of 1975: Hearings on H. R. 10612 Before the Sen. Comm. on Finance, 94th Cong., 2d Sess. 2771-72 (1976) (statement of the American Hospital Association proposal was opposed by the representatives of commercial laundries, who urged the Senate Finance Committee not to give special tax treatment to central laundries. *See*

Certain Committee Amendments to H. R. 10612: Hearings Before the Sen. Comm. on Finance, 94th Cong., 2d Sess. 200 (1976) (statement of John J. Contney, Executive Director, Linen Supply Association of America).

Although the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, contained an amendment to section 501(e) which would have included laundry services within the services specified in section 501(e), and this amendment was endorsed by the Senate Finance Committee, it was deleted from the Tax Reform Act by action on the floor of the Senate. *See* 122 Cong. Rec. 25915 (1976).

Thus a review of the legislative history supports the Internal Revenue Service's position that the statute reflects an explicit manifestation of legislative judgment and purpose not to afford cooperative hospital laundries tax exempt status.

It may be that Congress was misguided in its failure to include laundry services among those services specified in 501(c). It may be that in these days of high energy costs and rapidly accelerating hospital costs, tax exemption for mutual laundry services would be in the public interest. But, as the appellee's brief points out, "intensive lobbying pressure by commercial laundries resulted in hospital laundry activities being excluded from those activities to which specific legislative relief was granted." Appellee's brief, p. 29. The result reflects the political process in operation. Requests for relief or for change must be directed to Congress.

The district court relied on the line of cases holding that a hospital laundry service organization could qualify as a charitable organization under section 501(c). *Northern California Central Services, Inc. v. United States,* 591 F. 2d 620 (Ct. Cl. 1979); *Community Hospital Services, Inc. v. United States,* 79-1 U. S. T. C. ¶ 9301 (E. D. Mich. 1979); *Metropolitan Detroit Area*

Hospital Services, Inc. v. United States, 445 F. Supp. 857 (E. D. Mich. 1978); *Hospital Central Services Association v. United States,* 77-2 U. S. T. C. ¶ 9601 (W. D. Wash. 1977); *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (S. D. Ind. 1974).

In three of those cases, *Metropolitan Detroit Area Hospital Services, Community Hospital Services, Inc.,* and *Hospital Central Services Association,* the courts said they reached their decisions on the basis of the decision of the original case in that series, *United Hospital Services, Inc. v. United States, supra.* That case, in turn, found persuasive the reasoning in *Hospital Bureau of Standards and Supplies, Inc. v. United States,* 158 F. Supp. 560 (Ct. Cl. 1958). It is those two cases which should be considered.

In *Hospital Bureau,* plaintiff taxpayer was a New York corporation which purchased hospital supplies in bulk from suppliers on behalf of its 207 hospital members to whom the resulting savings accrued, and also maintained a research department and conducted technical analysis of supplies ordinarily used by its member institutions. It claimed exemption as a charitable organization for the calendar years 1952 and 1953. At the time of the decision there had been no discussion in Congress about enactment of a specific provision to provide tax exemption for hospital service organizations. The only issue before the court was whether the taxpayer could be considered a corporation "organized and operated exclusively for charitable purposes" under the predecessor provision to section 501(c). The Court of Claims held that it was entitled to be so considered. That decision provides little assistance to the statutory analysis we must now undertake when the statute contains the subsequently enacted provision directly applicable to hospital service organizations.

By the time of the decision in *United Hospital Services, Inc. v. United States,* the first case to consider the tax status of a hospital laundry service organization, the statute had been amended to include section 501(e). Nonetheless, the court held that the "case is completely analogous to *Hospital Bureau of Standards and Supplies.* . . ." 384 F. Supp. at 781. Although the court recognized that "Congress intentionally omitted ordinary, general and commercial laundry services from the blanket exemption granted to hospital cooperatives in Section 501(e)," *id.* at 780, it held the taxpayer could be considered a charitable organization under Section 501(c)(3) on its own merits. It is not clear whether the *United States Hospital Services* decision is dependent upon the fact that the taxpayer was incorporated and doing business some years before section 501(e) was adopted in 1968, a fact stressed by the court. Later cases have not limited the holding in that way. See *Metropolitan Detroit Area Hospital Services,* 445 F. Supp. at 860-61.

In the most recent decision on comparable facts, *Northern California Central Services, Inc. v. United States, supra,* the Court of Claims adhered to its prior decision in *Hospital Bureau.* After considering the effect of section 501(e), it concluded that the intent of Congress was not to narrow the class of organizations entitled to an exemption as a "charitable organization" but to broaden that class, "and that, as to laundry services, it left the law as it was." *Id.* at 624. As noted in our prior discussion, we believe the legislative history to show a contrary legislative intent than that found by the Court of Claims. We believe that it demonstrates that Congress recognized that hospital service organizations were not heretofore encompassed within section 501(c), or that their inclusion within that section was questionable. In order to clarify its position, Congress enacted section 501(e) to specify that cer-

tain types of hospital service organizations shall be considered as charitable organizations. If they had already been within section 501(c), the enactment of section 501(e) would have been a totally superfluous undertaking by Congress, an anomalous result which we cannot attribute to it.[10]

We are constrained to hold that section 501(e) specifies the types of hospital service organizations which are encompassed within the scope of section 501(c) as "charitable organizations," and that since HCSC-Laundry does not fall within section 501(e), it is not entitled to treatment as a tax exempt organization. For the foregoing reasons, we will reverse the judgment of the district court and remand for further proceedings not inconsistent with this opinion. Each side will bear its own costs.

---

10. The result of our decision will not necessarily be that plaintiff must hereafter pay income taxes. It may be possible to structure the arrangement with the hospitals in some way to avoid receipt of any net income. One possible approach was suggested by then Acting Commissioner of the Internal Revenue Service. See letter referred to in note 9 *supra*. We need not decide that issue now.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2286

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA,
Appellant

(D. C. Civil No. 78-1409)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: ROSENN and SLOVITER, *Circuit Judges* and
LAYTON, *District Judge**

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on February 21, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed July 11, 1979, be, and the same is hereby reversed, and the cause is remanded for further proceed-

* Honorable Caleb R. Layton, III, United States District Judge for the District of Delaware, sitting by designation.

ings not inconsistent with the opinion of this Court. Each party shall bear its own costs.

ATTEST:
THOMAS F. QUINN,
Clerk.

Certified as a true copy and issued in lieu of a formal mandate on June 30, 1980.

Test: THOMAS F. QUINN
Clerk, United States Court of Appeals for the Third Circuit.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-1409

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA

MEMORANDUM AND ORDER.

TROUTMAN, *J.* JULY 10, 1979

Plaintiff Hospital Central Services, Inc. is claiming a refund for federal income taxes paid for plaintiff's fiscal year ending June 30, 1976, in the amount of $10,395.00. Plaintiff is a nonprofit corporation under the Pennsylvania law and its sole activity is providing laundry and linen services to fifteen member nonprofit hospitals in southeastern Pennsylvania and to a nonprofit volunteer ambulance service. The issue is whether plaintiff, in furnishing this service, is exempt from taxation under Section 501(a) of the Internal Revenue Code of 1954, 26 U. S. C. § 501(a) as an organization described in 26 U. S. C. § 501(c)(3).

Both sides have moved for summary judgment. The following facts have been stipulated. Plaintiff was incorporated in January 3, 1967, as a nonprofit corporation under the Pennsylvania Nonprofit Corporation Law, adopted May 5, 1933. (Stipulation of Facts, ¶ 1). Its principal office is located at 2171 28th Street, S. W. Allentown, Pennsylvania. (¶ 2). Plaintiff's purpose is set forth

in paragraph 4 of the A 'cles of Incorporation as amended May 29, 1970:

> "A. To operate and maintain a hospital laundry and linen supply program for those public hospitals and nonprofit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with this corporation.
>
> B. To cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes.
>
> C. To accomplish the foregoing purposes in a manner consistent with the provisions of Section 501 (c)(3) of the Internal Revenue Code of 1954." (¶ 1, Exhibit A.)

On March 26, 1976, plaintiff filed an Application for Recognition of Exemption (Internal Revenue Service Form 1023) seeking exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. (¶ 4.) Under date of June 21, 1976, said application was rejected for the reason that "Since laundry services are not one of the services specified in Section 501(e)(I)(a), the organization does not meet the requirements of Section 501(e) of the Code, and thus is not exempt from Federal Income Tax under Section 501(c)(3). See Rev. Rul. 69-160 C. B. 1969-1, 147. Also see Rev. Rul. 69-663." (¶ 5.) Plaintiff filed its federal corporation income tax return (form 1120) for its fiscal year ended June 30, 1976, with the Internal Revenue Service Center at Philadelphia, Pennsylvania, on December 16, 1976. Said return indicated taxable income of $123,521.00 on which federal income tax of $10,395.00 was paid by plaintiff on December 16, 1976. (¶ 6.) On January 19, 1977, plaintiff filed

with the Internal Revenue Service a Claim for Refund for overpaid federal income tax for its fiscal year ended June 30, 1976, in the amount of $10,395.00. (¶ 7.) The Internal Revenue Service has informally advised plaintiff that this claim will be rejected but plaintiff has received no formal notice of claim disallowance.

Plaintiff provides laundry and linen services to fifteen nonprofit hospitals located in the Greater Lehigh Valley, Reading, Scranton and suburban Philadelphia, Pennsylvania, areas, and to the Cetronia Ambulance Corps serving the Village of Cetronia, Pennsylvania. All of the hospitals served and the ambulance corps have received federal income tax exemptions under Section 501(c)(3) of the Internal Revenue Code. (¶ 9.) In order to discharge its purposes, a hospital requires reliable and quality laundry and linen services. (§ 10.)

Other stipulations state that plaintiff constructed its plant to serve hospitals, some of which had in-plant facilities (¶ 19); that plaintiff meets sanitary and quality standards for hospital linens (¶ 21); the Lehigh Valley Hospital and Health Planning Council (the Council) concluded that plaintiff's shared approach to laundry service allows for more economical processing than in-plant processing (¶ 16) and the Council concluded that better quality service would be supplied in this fashion (¶ 25); all funds paid by member hospitals in excess of cost are placed in a fund for acquisition and replacement of equipment (¶ 27); plaintiff has never made a distribution of money or property nor have any net earnings inured to the benefit of any member or individual (§ 29).

The Government contends that plaintiff is not an exempt organization for two reasons. First, it is not a cooperative hospital service as defined in § 501(e), and because the Congress specifically intended to leave shared laundry service out of § 501(e), it follows that plaintiff is

also not exempt under § 501(c)(3).[1] The Government

1. § 501 provides in pertinent part:

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) List of exempt organizations.—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations.—For purposes of their title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization

1. (Cont'd.)

described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

also contends that plaintiff is a feeder organization as defined in § 502(a) [2] and thus is not an exempt organization.

Both of these contentions have been rejected by every Court that has ever considered them. See *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (D. Ind. 1974); *Metropolitan Detroit Area Hospital Services, Inc. v. United States,* 445 F. Supp. 857 (E. D. Mich. 1978); *Northern California Central Services, Inc. v. United States,* 43 AFTR 2d 79-543 (Ct. Claims, 1979); *Community Hospital Services, Inc. v. United States,* 43 AFTR 2d 79-931 (E. D. Mich. 1979); *Hospital Central Services Association v. United States,* 40 AFTR 2d 77-5642 (W. D. Wash. 1977).[3] While it is true that Congress did consider shared hospital services and expressly decline to include them in § 501(e)'s list of exempted activities, the courts have not held that such an exclusion had any application to the exemption of shared laundry service under § 501(c)(3). As Judge Dillin observed in the leading *United Hospital Services* case, the addition of § 501(e) to the Code did not exclude plaintiff in that case from consideration as a § 501(c)(3) charitable organization on its own merits. The purpose of § 501(e) was to enlarge the category of charitable organizations exempt under § 501(c)(3), not to modify or narrow § 501(c)(3). Thus, it is improper to consider the addition of § 501(e) as causing to be excluded

2. § 502(a) provides:

§ 502. Feeder organizations

(a) General rule.—An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

3. There is no authority on this issue at this time from any of the Courts of Appeals of any of the Circuits, but appeals are currently pending in the Sixth and Ninth Circuits.

from § 501(c)(3) any organization that would have been included in § 501(c)(3) but for § 501(e), even if such organization was explicitly excluded from § 501(e) itself. "This latter section (§ 501(c)(3)) was not modified by the legislature in any way, and the legislation does not purport to take away charitable status from a corporation which had already acquired it. Insofar as this case is concerned, Section 501(e) is irrelevant". *United Hospital Services, Inc. v. United States, supra,* at p. 781.

Likewise, the Court of Claims, in considering this issue in *Northern California Central Services, Inc. v. United States, supra,* observed that it had held a cooperative hospital purchasing organization was exempt under § 501(c)(3) in *Hospital Bureau of Standards and Supplies v. United States,* 158 F. Supp. 560 (1958). During subsequent legislative sessions members of Congress referred to that decision as a "leading case" indicating that the Congress was well aware of the decision; no effort was made however, to alter the *Hospital Bureau of Standards'* interpretation of § 501(c)(3), or to limit its applicability to exclude shared laundry services, during the legislative considerations that led to passage of § 501(e), which provision did explicitly exclude shared laundry services from its—§ 501(e)'s—list of exempt service organizations. Thus, the *Hospital Bureau of Standards* interpretation of § 501(c)(3) remained intact, even though Congress wrote other law to take care of IRS decisions of which Congress disapproved.

There is no inherent contradiction in holding that shared laundry service may be exempt from tax under § 501(c)(3) even though such service was explicitly denied an exemption under § 501(e). In declining to include shared laundry service within the express exemption provisions of § 501(e) Congress was merely declining to become embroiled in a very sensitive issue. As the Court

of Claims noted, commercial laundries were vehemently opposed to such tax exemption, and faced with such a heated controversy, it appears that the Congress, deciding it was not at that time sufficiently informed to decide the issue, left such a matter to the courts, by leaving such services out of § 501(e), yet leaving § 501(c)(3) unaffected.

Having decided that the absence of an express § 501(e) exemption does not automatically bar exemption under § 501(c)(3), we must decide if exemption under § 501(c)(3) is proper. We conclude that plaintiff is a charitable organization. Membership in plaintiff's organization is limited to public or non-profit hospitals, which hospitals themselves are charitable organizations. Net earnings by plaintiff, in excess of costs and funds for necessary reserves, are allocated to member hospitals in proportion to respective quantity or value of business done with each member hospital for the year giving rise to such earnings. (Stipulation Exhibit A, By-Laws, Article XI, Section 1.) It is undisputable that a hospital cannot discharge its purposes without reliable and quality laundry and linen services, which service must meet standards particular to hospital situations. Therefore, plaintiff undisputedly performs an integral and necessary function of charitable organizations, and we conclude that plaintiff is a charitable organization. This conclusion is consistent with the unanimous decisions of the courts that have considered this issue. See *United Hospital Services, Inc. v. United States, supra; Metropolitan Detroit Area Hospital Services, Inc. v. United States, supra; Northern California Central Services, Inc. v. United States, supra; Community Hospital Services, Inc. v. United States, supra; Hospital Central Services Association v. United States, supra.*

The Government has also contended that plaintiff is a "feeder" organization, and is not entitled to a charitable

exemption because of the provisions of § 502(a). However, we conclude that that provision does not apply. That provision applies only to a profit-making enterprise which pays its profits to one or more charitable organizations. In this case, plaintiff is not a profit-making enterprise at all, but a non-profit enterprise wholly controlled by charitable organizations "in order to effect economies in their own operations". See *United Hospital Services, Inc. v. United States, supra,* at p. 782. Also, the applicable Treasury Regulation on Income Tax, 26 C. F. R. § 1.502-1, *Feeder Organizations,* provides as follows in pertinent part:

> "(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or

> business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.***"

In this case, the purpose of the plaintiff is an integral part of the exempt activities of the parent organization—laundry is an integral part of the functions of a hospital. Thus, we conclude that plaintiff is not a feeder organization and is, therefore, entitled to exemption.

In conclusion, we find that plaintiff is not barred from exemption because its activities were not expressly exempted from taxation under § 501(e), that plaintiff is an exempt organization under § 501(c)(3) and that the provisions of § 502(a) do not apply to plaintiff. Accordingly, we will grant plaintiff's motion for summary judgment, and deny defendant's motion for summary judgment. Our findings, conclusions and the result thus reached are consistent with the concern and the desires of the Government to curb rising hospital costs. A different result would directly affect such costs to the detriment of the elderly and others dependent upon continued hospital services.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-1409

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA

ORDER.

TROUTMAN, *J.*

AND NOW, this 10th day of July, 1979, IT IS ORDERED that plaintiff's motion for summary judgment is GRANTED and defendant's motion for summary judgment is DENIED.

E. MAC TROUTMAN

J.

No. 80-338

In the Supreme Court of the United States

OCTOBER TERM, 1980

HCSC-LAUNDRY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

LAWRENCE G. WALLACE
Acting Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ROBERT A. BERNSTEIN
DAVID ENGLISH CARMACK
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-338

HCSC-LAUNDRY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

QUESTION PRESENTED

Whether a corporation operated by several tax-exempt charitable hospitals for the purpose of providing hospital laundry and linen supply services is itself a tax-exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code of 1954.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutes and regulations involved	1
Statement	1
Discussion	4
Conclusion	10
Appendix	1a

TABLE OF AUTHORITIES

Cases:

Associated Hospital Services, Inc. v. *Commissioner*, 74 T.C. 213, pending on appeal, No. 80-3596 (5th Cir.)	8, 9
Bulova Watch Co. v. *United States*, 365 U.S. 753	5
Chart, Inc. v. *United States*, 491 F. Supp. 10, pending on appeal, Nos. 80-1138, 80-1139 (D.C. Cir.)	7
Commissioner v. *Kowalski*, 434 U.S. 77	4
Community Hospital Services, Inc. v. *United States*, 79-1 U.S.T.C. ¶ 9301, pending on appeal, No. 79-1286 (6th Cir.)	7
Hospital Bureau of Standard & Sup. v. *United States*, 158 F. Supp. 560	5, 8
Hospital Central Services Ass'n v. *United States*, 623 F. 2d 611	7, 8
Metropolitan Detroit Area Hospital Services v. *United States*, 445 F. Supp. 857, pending on appeal, Nos. 78-1205, 78-1218 (6th Cir.)	7
National Muffler Dealers Assn. v. *United States*, 440 U.S. 472	
Northern California Central Services, Inc. v. *United States*, 591 F. 2d 620	7, 8, 9
United Hospital Services, Inc. v. *United States*, 384 F. Supp. 776	7

PREVIOUS PAGE WAS BLANK

Statutes and regulations: Page

Internal Revenue Code of 1954 (26 U.S.C.):

Section 1 4
Section 11 4
Section 61(a) 4
Section 501(a) 1, 4
Section 501(c) 1, 4
Section 501(c)(3) 2-3, 4, 5, 7, 8
Section 501(e) 1, 3, 4, 5, 6, 7, 8
Section 502 ..... 5, 8, 1a
Section 502(a) 1, 1a

Revenue and Expenditure Control Act of 1968, Pub. L. No. 90-364, Section 109(a), 82 Stat. 251.. 6
26 U.S.C. 7428 9
Treasury Regulations on Income Tax, Section 1.502-1(b) (26 C.F.R.) 1, 8, 1a

Miscellaneous:

114 Cong. Rec. 7516 (1968) 6
114 Cong. Rec. 8111-8112 (1968) 6
122 Cong. Rec. 25915 (1976) 7
Hearings on Certain Committee Amendments to H.R. 10612 Before the Senate Comm. on Finance, 94th Cong., 2d Sess. (1976) 6
H.R. Conf. Rep. No. 1030, 90th Cong., 1st Sess. (1967) 6
H.R. Conf. Rep. No. 1533, 90th Cong., 2d Sess. (1968) 6
Rev. Rul. 54-305, 1954-2 Cum. Bull. 127 5
S. Rep. No. 744, 90th Cong., 1st Sess. (1967) 6
S. Rep. No. 94-938 (Pt. 2), 94th Cong., 2d Sess. (1976) 7
Staff of Comm. of Conference, 90th Cong., 2d Sess., *Explanation of the Bill H.R. 15414* (Comm. Print 1968) 6
Tax Reform Act of 1975: Hearings on H.R. 10612 Before the Senate Comm. on Finance, 94th Cong., 2d Sess. (1976) 6-7

OPINIONS BELOW

The memorandum and order of the district court (Pet. App. A22-A31) is reported at 473 F. Supp. 250. The opinion of the court of appeals (Pet. App. A1-A19) is reported at 624 F. 2d 428.

JURISDICTION

The judgment of the court of appeals was entered on June 6, 1980 (Pet. App. A20-A21). The petition for a writ of certiorari was filed on September 2, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of Sections 501(a), (c) and (e) of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. 2-4. The relevant provisions of Section 502(a) of the Internal Revenue Code of 1954 (26 U.S.C.) and of Section 1.502-1(b) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) are set forth at Appendix, *infra*, 1a-2a.

STATEMENT

Petitioner is a corporation organized under the Pennsylvania Nonprofit Corporation Law "[t]o operate and maintain a hospital laundry and linen supply program for those public hospitals and non-profit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with [it]" (Pet. App. A3 & n.1). Petitioner provided laundry and linen service to 15 nonprofit hospitals located in the Greater Lehigh Valley, Reading, Scranton, and

suburban Philadelphia, Pennsylvania, and to the Cetronia Ambulance Corps. Petitioner has no capital stock. Each participating hospital paid $500 as membership dues to petitioner for the taxable year at issue. Cetronia Ambulance Corps paid no membership dues to receive petitioner's laundry service. Apart from the membership dues, petitioner's only income is derived from a charge of 1½ cents per pound of laundry serviced paid by each customer in addition to petitioner's actual cost. For this purpose, "cost" includes operating expenses, debt retirement, and linen replacement. The amounts petitioner charged for laundry service in excess of its cost were placed in a fund for equipment replacement and acquisition (Pet. App. A3, A5).

No part of petitioner's net earnings inures to the benefit of any individual (Pet. App. A6-A7).

Petitioner was formed after the Lehigh Valley and Health Planning Council determined that a shared nonprofit, off-premises laundry would best accommodate the requirements of the member hospitals both from the viewpoint of quality of service and economies of scale. At the time the Council made this determination, a commercial laundry had rejected the offer to take on the full volume of laundry business of all the hospitals involved. Most of the other available commercial laundries were not capable of managing the heavy volume of the hospitals (Pet. App. A3-A5).

Petitioner's laundry plant was built and equipped at a cost of approximately $2 million, which it borrowed from local banks by using as collateral 15-year contracts from ten area hospitals. Petitioner employs approximately 125 persons (Pet. App. A5).

On March 26, 1976, petitioner applied for exemption from federal income taxation under Section 501

(c)(3) of the Internal Revenue Code. This section authorizes exemption for corporations "organized and operated exclusively for religious, charitable, scientific, * * * or educational purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *." On June 21, 1976, the Internal Revenue Service rejected petitioner's application on the ground that Section 501(e) of the Internal Revenue Code was the exclusive provision under which shared hospital service organizations could be classified as an organization "organized and operated exclusively for charitable purposes" and that shared hospital service organizations providing laundry service were not included in Section 501(e) (Pet. App. A5-A8, A23).

On December 16, 1976, petitioner filed its federal corporate income tax return for its taxable year ended June 30, 1976, on which it reported taxable income of $123,521 and paid a tax of $10,395. Shortly thereafter, petitioner filed a claim for refund of the taxes paid for this fiscal year (Pet. App. A23-A24).

After the Internal Revenue Service took no action on its claim for refund within six months, petitioner commenced this refund suit in the United States District Court for the Eastern District of Pennsylvania (Pet. App. A8). The district court held that petitioner was entitled to exemption as an organization described in Section 501(c)(3) and entered summary judgment for it (Pet. App. A22-A31).

The court of appeals reversed. It concluded that Section 501(e) was the exclusive provision under which cooperative hospital service organizations could obtain tax exemptions and that the omission of laundry services from the enumerated list of activities of such cooperative service organizations showed that

Congress intended to exclude cooperative hospital laundries from tax exempt status (Pet. App. A1-A21).

DISCUSSION

1. The decision below correctly held that cooperative hospital laundry service corporations such as petitioner are not exempt from tax under Section 501(c)(3) of the Code.

It is a fundamental principle of our income tax system that absent a specific statutory exception, the gross income of all persons, natural or corporate, is subject to tax. See Sections 1, 11, 61(a) of the Code (26 U.S.C.); *Commissioner* v. *Kowalski*, 434 U.S. 77, 82-83 (1977). One of the exceptions to this general rule is Section 501(a) of the Internal Revenue Code of 1954 (Pet. 2), which exempts the income of organizations described in Section 501(c) (Pet. 2-3). Organizations exempt under Section 501(c)(3) include "[c]orporations * * * organized and operated exclusively for * * * charitable * * * purposes * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *."

Section 501(e) specifically deals with the tax-exempt "charitable" status of specified mutual enterprises owned and operated by and for tax-exempt hospitals (see Pet. 3-4). It provides in pertinent part that a shared hospital service corporation will be treated as an organization described in Section 501(c)(3) if it provides certain specific services to certain tax-exempt hospitals and meets other qualifications. However, laundry service is not included in the enumerated statutory list.

The absence of laundry services from the detailed list of activities that a hospital service corporation

can provide and maintain tax-exempt status supports the conclusion of the court below that in enacting Section 501(e), Congress intended to exclude any other means by which shared hospital services organizations might qualify for exemption. That section lists the specific types of services which can be performed by qualifying organizations and sets out the precise organizational criteria they must satisfy. It is a basic principle of statutory construction, particularly with regard to tax cases, that a specific statute controls over a general provision. *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 761 (1961). Here, Section 501(e) specifically addresses jointly operated hospital service organizations. Since shared hospital service organizations providing laundry services are not included in Section 501(e), they are not entitled to tax-exempt status under Section 501(c)(3).

As the court of appeals pointed out (Pet. App. A12-A16), the legislative history confirms that Congress intended Section 501(e) to be controlling. Prior to consideration of the specific problem of tax-exempt status of shared hospital service organizations, the law was uncertain. In accordance with the pertinent Treasury Regulations, the Internal Revenue Service took the position that if two or more tax exempt hospitals created an entity to perform ordinary commercial services for them, the entity was a so-called "feeder organization" under Section 502 of the Code (Appendix, *infra*, 1a) and would not be entitled to tax-exempt status. Rev. Rul. 54-305, 1954-2 Cum. Bull. 127. The Court of Claims, however, rejected this position in *Hospital Bureau of Standard & Sup.* v. *United States*, 158 F. Supp. 560 (1958). After

expressly noting the uncertainty in the law,[1] Congress enacted Section 501(e) in 1968. See Section 109(a), Revenue and Expenditure Control Act of 1968, Pub. L. No. 90-364, 82 Stat. 251.

In considering the provisions in the Tax Adjustment Bill of 1968 that ultimately became Section 501(e), the Senate sought to include laundry service among the enumerated list of services that a cooperative hospital corporation could provide and still maintain its tax-exempt status. The Treasury supported the Senate amendment. 114 Cong. Rec. 7516, 8111-8112 (1968). At the urging of commercial laundry interests, however (see *Hearings on Certain Committee Amendments to H.R. 10612 Before the Senate Comm. on Finance*, 94th Cong., 2d Sess. 608 (1976), the Conference Committee would accept only a more limited version of the Senate amendment. In recommending the adoption of Section 501(e), the House managers emphasized that shared hospital service organizations performing laundry services were not entitled to tax-exempt status under the new provision. H.R. Conf. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968); Staff of Comm. of Conference, 90th Cong., 2d Sess. 20, *Explanation of the Bill H.R. 15414* (Comm. Print 1968).

Finally, in 1976, at the urging of the amicus American Hospital Association, the Senate Finance Committee proposed an amendment that would have added laundry organizations to those specified in Section 501(e) (*Tax Reform Act of 1975: Hearings on H.R. 10612 Before the Senate Comm. on Finance*,

---

[1] See S. Rep. No. 744, 90th Cong., 1st Sess. 200-201, 318 (1967); H.R. Conf. Rep. No. 1030, 90th Cong., 1st Sess. 73 (1967); 114 Cong. Rec. 7516, 8111-8112 (1968); and, Staff of Comm. of Conference, 90th Cong., 2d Sess. 1, 20, *Explanation of the Bill H.R. 15414* (Comm. Print 1968).

94th Cong., 2d Sess. 2765-2772 (1976); S. Rep. No. 94-938 (Pt. 2), 94th Cong., 2d Sess. 76-77 (1976)). However, the amendment was defeated on the Senate floor (122 Cong. Rec. 25915 (1976)).

2. Accordingly, it is beyond dispute that Section 501(e) specifies the types of hospital service organizations that are encompassed within the scope of Section 501(c)(3) as charitable organizations. Since hospital laundries were deliberately excluded from the enumerated statutory list, the decision below correctly held that petitioner is not entitled to tax-exempt status as a charitable organization. Indeed, to hold otherwise would resuscitate the very statutory amendment in favor of hospital laundries proposed both in 1968 and 1976 which Congress twice rejected. The court of appeals properly refused to flout this clear expression of legislative purpose.

In so holding, the court below acknowledged (Pet. App. A16-A17) that its ruling was squarely in conflict with *Northern California Central Services, Inc.* v. *United States*, 591 F.2d 620 (Ct. Cl. 1979), as with several district court decisions. See *United Hospital Services, Inc.* v. *United States*, 384 F. Supp. 776 (S.D. Ind. 1974); *Community Hospital Services, Inc.* v. *United States*, 79-1 USTC ¶ 9301 (E.D. Mich. 1979), pending on appeal, No. 79-1286 (6th Cir.); *Metropolitan Detroit Area Hospital Services* v. *United States*, 445 F. Supp. 857 (E.D. Mich. 1978), pending on appeal, Nos. 78-1205, 78-1218 (6th Cir.). See also *Chart, Inc.* v. *United States*, 491 F. Supp. 10 (D. D.C. 1979) (cooperative hospital data processing corporation exempt under Section 501(c)(3) whether or not it qualifies under Section 501(e)), pending on appeal, Nos. 80-1138, 80-1139 (D.C. Cir.). On the other hand, in *Hospital Central Services Ass'n* v. *United States*, 623 F.2d 611 (1980), the Ninth Cir-

cuit upheld the Commissioner's reading of Section 501(e) and "agree[d] with the Third Circuit for the reasons stated in its opinion" (623 F.2d at 612). Finally, in *Associated Hospital Services, Inc.* v. *Commissioner*, 74 T.C. 213, 231 (1980), pending on appeal, No. 80-3596 (5th Cir.), the Tax Court ruled that such hospital laundry service corporations are taxable, albeit on the ground that they are profit-making "feeder organizations" under Section 502 and Treasury Regulations, Section 1.502-1(b) (26 C.F.R.), Appendix, *infra*, 1a-2a.

3. The fundamental error in the decision of the Court of Claims in *Northern California Central Services, Inc.* was its failure to recognize that Congress did not accept the gloss that court put upon the predecessor of Section 501(c)(3) in *Hospital Bureau of Standard & Sup.* v. *United States*, *supra*. Rather, after noting the uncertainty in the law (see page 6, *supra*), Congress resolved the disagreement between the Court of Claims and the Internal Revenue Service by establishing a new set of statutory standards in Section 501(e) to deal with the specific problems posed by shared hospital service organizations. Given the deliberate exclusion of mutual laundry corporations from Section 501(e), it blinks at reality to suggest, as the Court of Claims did in *Northern California Central Services, Inc.*, that Congress "may have wished not to encourage cooperative hospital laundries by new tax exemptions, to which commercial laundries made vehement objections, yet to leave such laundries free to obtain from the courts the exemptions that existing law might afford them" (591 F.2d at 624).

In support of this conclusion, the Court of Claims stated that Congress did not include laundries in Section 501(e) because it was too controversial a

matter about which it was not sufficiently informed and thereby determined "to leave such a matter to the courts" (591 F.2d at 624). But as the Tax Court correctly pointed out in *Associated Hospital Services, Inc.* v. *Commissioner, supra,* 74 T.C. at 231, "Congress was indeed well informed on this subject—far better, perhaps, with all of the extended hearings, Committee considerations, and floor debates, than a court of law could be on the basis of an administrative record involving only one single organization." There is accordingly no statutory basis for tax exemption of cooperative hospital laundries.

As matters now stand, hospital laundry service corporations such as petitioner would lose their exemptions in the Third and Ninth Circuits but could retain such status in the Court of Claims. Moreover, resolution of the conflict is important to the proper administration of the revenue laws. We are advised by the Internal Revenue Service that there are currently four cases pending in the Court of Claims presenting the question. There are, moreover, four cases pending in the Fifth, Sixth, and District of Columbia Circuits.

Finally, at the administrative level, during the past four months, the Service has issued seven final adverse determination letters to hospital laundry service corporations and it is accepted that these organizations will seek review of these rulings under the declaratory judgment procedure provided by 26 U.S.C. 7428. Fourteen additional cases are awaiting ruling action by the Service. Given the undisputed conflict of decisions and the administrative importance of the question to the private health care industry, we do not oppose the petition for certiorari.[2]

---

[2] In light of the narrow scope of the question presented and the clarity of the legislative history discussed above, the Court may wish to consider summary affirmance.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

LAWRENCE G. WALLACE*
Acting Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ROBERT A. BERNSTEIN
DAVID ENGLISH CARMACK
Attorneys

OCTOBER 1980

---

* The Solicitor General is disqualified in this case.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

Section 502 FEEDER ORGANIZATIONS.

(a) *General Rule.*—An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.502-1 *Feeder organizations.*

* * * * *

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent

organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of—

(1) A parent organization and one or more of its subsidiary organizations; or

(2) Subsidiary organizations having a common parent organization.

An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

* * * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1980 330423 107

No. 80-338

In the Supreme Court of the United States

OCTOBER TERM, 1980

HSCS-LAUNDRY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

LAWRENCE G. WALLACE
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-338

HSCS-LAUNDRY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

We wish to call the Court's attention to the recent opinion of the Sixth Circuit in *Metropolitan Detroit Area Hospital Services, Inc.* v. *United States*, Nos. 78-1205, 78-1218 (Nov. 4, 1980). There, in accord with the decision below, the Court held "[t]he conclusion seems inescapable that Congress has determined that mutual laundries should not be treated as an organization 'organized and operated exclusively for charitable purposes'" (~~slip op. 9~~). For the

(1) Appendix, infra, 11a

convenience of the Court, we have reproduced this opinion in the Appendix, *infra*.

Respectfully submitted.

LAWRENCE G. WALLACE *
Acting Solicitor General

NOVEMBER 1980

---

* The Solicitor General is disqualified in this case.

APPENDIX

Nos. 78-1205, 78-1218

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

METROPOLITAN DETROIT AREA HOSPITAL SERVICES, INC., PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MICHIGAN SOUTHERN DIVISION

Decided and Filed November 4, 1980.

Before: KEITH and MERRITT, Circuit Judges, and PECK, Senior Circuit Judge.

KEITH, Circuit Judge. Plaintiff Metropolitan Detroit Area Hospital Services, Inc. (Metropolitan) is a non-profit corporation owned and operated cooperatively by six Detroit area hospitals. Its purpose is to provide laundry services to member hospitals. Prior to the incorporation of Metropolitan on June 15, 1970, each participating hospital maintained separate

"in-house" laundry facilities to furnish the services now provided by Metropolitan. In essence, the hospitals pooled their resources to form the laundry cooperative, and now pay to Metropolitan a rate designed to cover the laundry's costs and overhead, including debt retirement.

At present, Metropolitan provides laundry service only.[1] Metropolitan is controlled by a Board of Trustees, the members of which are appointed by the governing bodies of the participating hospitals. Each hospital appoints two members to Metropolitan's Board. Each participating hospital is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, 26 U.S.C. 501(c)(3). Each hospital is publically owned and operated as a municipal corporation. Metropolitan is exempt from Michigan *ad valorem* personal and real property taxes and from Michigan sales tax. M.C.L.A. 211.7; *Hospital Purchasing Services* v. *City of Hastings*, 11 Mich. App. 500, 161 N.W. 2d 759 (1968)

In 1973, Metropolitan paid $4,811.00 in federal income taxes. The pleadings do not show what amount, if any, Metropolitan paid in income taxes for 1974. In 1975, it paid $39,822.00. On April 17, 1975, Metropolitan filed with the Internal Revenue Service an application for recognition of exemption, asserting that it was a charitable organization under Internal Revenue Code 26 U.S.C. § 501(c)(3) and, thus, entitled to federal income tax exemption under § 501(a) of the Code. The IRS denied Metropolitan the exemption on September 1, 1976 and on February 11, 1977, informed Metropolitan that it had found in-

---

[1] However, the Articles of Incorporation allow for a significant expansion of hospital services.

sufficient grounds upon which to reduce Metropolitan's tax liability.

On April 1, 1977, Metropolitan filed its complaint in the district court against the IRS to recover $44,633.00. The basis for the refund claim was that Metropolitan was entitled to a tax-exempt status. The district court granted summary judgment, pursuant to Fed.R.Civ.P. 56 in favor of Metropolitan. The United States brought this appeal.

The stated facts are undisputed by the parties. The only question demanding resolution is whether, under these facts, the plaintiff is entitled to a federal income tax exemption under Section 501(a) because of a tax exempt status under Section 501(c)(3) of the Internal Revenue Code.

I.

There are two Code provisions that are relevant for our discussion of this tax problem. Section 501(c)(3) grants a tax exemption to all organizations that are:

> "organized and operated exclusively for religious, charitable, scientific or educational purposes . . . [and] no part of the earnings of which inure to the benefit of any private shareholder or individual." (I.R.C. § 501(c)(3).[2]

Metropolitan claims that it is organized for a charitable purpose, and therefore is exempt under this section of the Code.

Section 501(e) is the second provision that we must consider. Section 501(e) specifically addresses the

---

[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as in effect during the years at issue.

tax-exempt status of those cooperatives formed by § 501(c)(3) tax-exempt hospitals. The government contends that § 501(e) is the controlling statutory section. Our goal is to ascertain the intent of Congress in enacting § 501(e).

Section 501(e) provides in pertinent part:

> (e) Cooperative hospital, services organizations—for purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—
>
> (1) such organization is organized and operated solely—
>
> > (A) to perform on a centralized basis, one or more of the following of services which, if performed on its own behalf by a hospital which is an organization described in Subsection (c)(3), and would be exempt from taxation under Subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and
> >
> > (B) to perform such services solely for two or more hospitals each of which is—
> >
> > > (i) an organization described in Subsection (c)(3) which is exempt from taxation under Subsection (a),
> > >
> > > (ii) a constituent part of an organization described in Subsection (c)(3)

which is exempt from taxation under Subsection (a) and which, if organized and operated as a separate entity, would substitute an organization described in Subsection (c)(3), or

(iii) owned and operated by the United States, a state, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in Subsection (c)(3) and exempt from taxation under Subsection (a) shall be treated as a hospital and as an organization referred to in Section 170(b)(1)(A)(iii).

The district court found for the taxpayer, holding that Metropolitan met the requirements of § 501(c)(3) as a charitable organization, and thus was entitled to tax exempt status under Section 501(a). In answering the question of whether Metropolitan was a § 601(c)(3) organization, the district court used a three-pronged analysis. First, the court inquired whether the taxpayer was entitled to claim a tax exemption directly under 501(c)(3) or whether it was limited to Section 501(e). Assuming Metropolitan was so entitled, the court next inquired

whether it was in fact a § 501(c)(3) organization? And finally, the court inquired whether § 502, the "feeder provision," could block any exemption to which Metropolitan might otherwise have been entitled? The government appeals from the holding that Metropolitan is a § 501(c)(3) organization, and argues that § 501(e) is the controlling statutory provision.

On appeal the question before us is whether § 501(e) specifically limits the type of hospital cooperative services that may be treated as a tax exempt § 501(c)(3) organization. If answered in the affirmative, our inquiry is complete. A cursory reading of 501(e) reveals that laundry services are absent from the inventory of hospital cooperatives singled out for tax exempt treatment. From this one might infer that Congress intended to exclude laundry services from tax exempt treatment.[3] However, some lower

---

[3] *See* Rev. Rul. 69-160 G.B. 1969-I, 147; Rev. Rul. 69-633. In pertinent part, Revenue Ruling 69-633 states:

> Situation 1: A number of hospitals exempt from federal income tax under Section 501(c)(3) of the Code formed a laundry service organization. The organization was organized and operated on a cooperative basis to serve only the hospitals that organized it. All net earnings are required to be allocated or paid to patrons on the basis of services performed for them.
>
> Question 1: Can the organization qualify for exemption from Federal Income Tax as a cooperative hospital service organization under Section 501(c)(3) of the Code by reason of Section 501(e)?
>
> Answer: In order to qualify as a cooperative hospital service organization under the provisions of Section 501(e) of the Code, an organization must be organized and operated solely to perform one or more of the services specified in Section 501(e)(1)(A) of the Code. Since laundry services are not one of the services speci-

courts have not so interpreted this omission.[4] Rather, Section 501(e) has been held to be a "safe harbor" for those hospital services so catalogued.[5] Under this view, the fact that laundry services are outside § 501 (e) is irrelevant.

This interpretation enables a hospital laundry cooperative to apply for and receive a § 501(c)(3) exemption under the theory that clean laundry is integrally related to the delivery of health services. In other words, clean laundry is indispensable to the proper functioning of any hospital providing modern health care. The district court specifically found that Metropolitan, the non-profit laundry cooperative, satisfied the requirements for § 501(c)(3) charitable organization and was therefore entitled to a tax exemption.

In determining that § 501(c)(3) of the Code applied to Metropolitan, the district court enumerated the following factors indicative of Metropolitan's charitable nature and purposes:

---

fied in that section, the organization does not meet the requirements of Section 501(e) of the Code, and thus is not exempt from Federal income tax under Section 501 (c)(3). See Rev. Rul. 69-160, G.B. 1969-1, 147.

See also H.R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968); Committee of Conference on H.R. 15414, 90th Cong., 2d Sess. Revenue and Expenditures Control Act of 1968. Explanation of the Bill H.R. 15414. As agreed to in Conference 20 (Comm. Print 1968).

[4] *See, e.g., Community Hospital Services, Inc.* v. *United States*, 79 U.S.R.C. § 9301 (E.D. Mich. 1979); *Hospital Central Services Association* v. *United States*, 77-2, U.S.T.C. § 9601 (W.D. Wash. 1977); *Hospital Bureau of Standards and Supplies, Inc.* v. *United States*, 158 F.Supp. 560 (Ct. Cl. 1958).

[5] *See Metropolitan Detroit Area Hospital Services, Inc.* v. *United States*, 445 F.Supp. 857, 860 (E.D. Mich. 1978).

(1) Metropolitan is governed by a Board of Trustees, the members of which also serve on governing boards of the various participating hospitals. Consequently, hospital members collectively control and operate Metropolitan *in their own interest;* (2) All members receive a benefit from Metropolitan's centralized, standardized services, including reduced costs and increased floor space; (3) For-profit hospitals are not permitted to participate in the cooperative *and no profits (as that term is traditionally defined)* are realized by Metropolitan; (4) Metropolitan provides a service which is essential to the proper functioning of its tax exempt members. Indeed, prior to the incorporation of Metropolitan each member hospital performed these services independently through "in-house" laundries; (5) The Articles of Incorporation of Metropolitan provide that upon its dissolution all proceeds shall be distributed to charitable organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.[6]

Apparently the lower court was persuaded that the above factors brought Metropolitan within the charitable purpose rubric of § 501(c)(3). The twin findings by the district court that 501(e) was meant to be only a "safe harbor" for hospital cooperatives and that this laundry was a charitable organization constitute the basis for the holding that Metropolitan is entitled to an exemption under 501(a).

---

[6] District Court's Memorandum at *Metropolitan Detroit Area Hospital Services, Inc.* v. *United States,* 445 F.Supp. 857, 862 (E.D. Mich. 1978).

Our examination of the legislative history of Section 501(e) compels us to reverse the district court.[7] We believe that 501(e) was intended by Congress to be a definitive inventory rather than merely a descriptive list of hospital cooperatives. Thus, we hold that the omission of laundry services from 501(e) defeats Metropolitan's claim for tax exempt status.

In 1968, the Senate drafted an amendment to the Tax Adjustment Bill of 1968 which proposed to treat the majority of those organizations formed by tax exempt hospitals as charitable organizations.[8] Under this amendment, laundry services would have been included as a charitable organization. However, the House did not pass this all-encompassing amendment, and the matter had to be resolved by a Conference Committee. A substitute amendment endorsed by the Conference Committee was ultimately passed by Congress. The report from the Conference Committee reads:

> The new subsection *does not grant tax exempt status* if the hospital service organization performs any services other than those specified in the new subsection (for example, laundry services), or performs any services for any person or organization other than a tax exempt hospital. H.R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968) (emphasis added).

---

[7] See n. 3 *supra*.

[8] Moreover, the Tax Reform Act of 1976, Pb. 1 94-455, 90 Stat. 1520, contained an amendment to Section 501(e) which would have included laundry services within the services specified in Section 501(e). It was deleted from the Tax Reform Act on the floor of the Senate. *See* 122 Cong. Rec. 25915 (1976).

Moreover, the statements of Congressional leaders made interpreting the Conference Committee report eliminate any ambiguity concerning the status of laundry services. For example, the Honorable George A. Smathers, the ranking member of the Senate Committee on Finance stated:

> "The conferees agreed to the Senate provision . . . but limited the exemption to a joint enterprise which is organized and operated solely to perform data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications or personnel functions for hospitals. 114 Cong. Rec. § 7480 (1968) (remarks of Sen. Smathers) *reprinted in* [1968] U.S. Code Cong. & Ad. News 2422, 2427.

It is an elementary rule of statutory construction that a specific provision controls when the same subject matter is addressed by a more general provision.[9] Appellee contends that Metropolitan qualifies for 501 (c) (3) treatment on its own merits, but to hold that a hospital cooperative can qualify under 501 (c) (3) notwithstanding the more specific language of 501 (e) would be to attribute to Congress the passing of a superfluous statute. Therefore, we find that a tax exemption is available for a cooperative under 501 (c) (3) only if it is one of the cooperatives listed in 501 (e).

Congress has restricted the proliferation of hospital cooperatives by specifically naming the cooperatives entitled to receive 501 (c) (3) treatment. Laun-

---

[9] "[I]t is familiar law that a specific statute controls over a general one without regard to priority of enactment." *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 758 (1961). *See also Nitzberg* v. *Commissioner*, 580 F.2d 357 (9th Cir. 1978).

dry cooperatives were not so favored. As the government aptly observes, granting mutual laundry organizations exemptions under § 501(c)(3) permits a greater or more substantial tax advantage than that provided § 501(e) shared service organizations.[10] This would be contrary to Congressional intent to withhold even the more limited § 501(e) benefits from them. The conclusion seems inescapablethat Congress has determined that mutual laundries should not be treated as an organization "organized and operated exclusively for charitable purposes."

We find that § 501(e) precludes Metropolitan from being considered on its own merits as a § 501(c)(3) charitable organization. Section 501(e) states that an organization under 501(e) "shall be treated" as an organization organized and operated exclusively for charitable purposes. Implicit in the wording of the statute itself is the idea that such cooperatives are not themselves "organizations" organized exclusively for charitable purposes,[11] although Congress

---

[10] For example if a § 501(c)(3) organization, in addition to performing the function constituting the basis for its exemption, regularly carries on a "trade or business . . . not substantially related to its charitable function," it will not lose its exemption but rather will be taxed on unrelated business income under § 511. However, the § 501(e) organization which regularly carries on a business will not be able to retain its exemption and be taxed only on the unrelated business income. Instead, it will be in danger of not qualifying for the exemption. Code § 513(e) gives a two-prong test for the imposition of the unrelated business income tax: a business activity which (1) regularly carried on and (2) not substantially related to the exempt purposes of the organization. *See also* Rev. Rul. 69-160, 1969-1. Cum. Bull. 147.

[11] *See generally*, Tuthill, *Qualifying as a Tax Exempt Cooperative Hospital Service Organization*, 50 Notre Dame Lawyer 448 (1975).

did choose to have certain cooperatives treated as though they were so organized and operated. We believe it is unfortunate that § 501(e) acts as a disincentive for the sharing, among non-profit hospitals, of laundry and other necessary costs, but this policy decision to exclude laundry service cooperatives from tax exempt treatment is well within the sphere of legislative prerogative. Congress might well wish to reconsider this decision.

We are not alone in concluding that the legislative intent in excluding laundry services manifested a specific Congressional purpose. Recently the Third Circuit in *HCSC-Laundry* v. *United States*, —— F.2d —— 3rd Cir. No. 78-1409 (June 6, 1980) held that the "legislative history supports the Internal Revenue Service's position that the statute reflects an explicit manifestation of legislative judgment and purpose not to "*afford cooperative hospital laundries tax exempt status.*" *Id.* at 15 (emphasis supplied).[12]

---

[12] The Ninth Circuit adopted this position in a *per curiam* opinion:

> A group of charitable § 501(2)(3) hospitals may jointly create and own a tax-exempt entity under § 501(e)(1)(A) to perform certain functions: e.g. computer service, purchasing, warehousing, laboratory, printing, billing and collecting, and other services listed in § 501(e)(1)(A) of the Code. The issue is whether, under § 501(c)(3), the hospitals may create tax-exempt entities to perform services not listed in § 501(e)(1)(A).
>
> After a careful examination of the legislative history of § 501(e)(1)(A) and of established legal principles which we need not repeat here, the Third Circuit held that Congress had intentionally omitted laundry services from the list of commercial services for which charitable hospitals could form jointly-owned entities that would be tax exempt.
>
> Whether the legislative decision to favor the commercial laundry industry by removing a tax advantage from

For the reasons stated above, the judgment of the district court is reversed. Each party is to bear its own costs.

---

competitors was a wise or equitable decision is obviously not a judicial question. On the only judicial question—the meaning of the tax law—we agree with the Third Circuit for the reasons stated in its opinion.

Hospital Central Services, Assoc. v. *United States of America*, No. 77-3701 (9th Cir. July 21, 1980).

☆ U. S. GOVERNMENT PRINTING OFFICE: 1980 332763 133

No. 80-338

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

HCSC—LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF AMICUS CURIAE OF THE AMERICAN HOSPITAL ASSOCIATION IN SUPPORT OF THE PETITION FOR CERTIORARI

JAY HOMER HEDGEPETH
KAREN KOPPEL KAUNITZ
840 North Lake Shore Drive
Chicago, Illinois 60611

Attorneys for Amicus Curiae
American Hospital Association

Pandick Press Midwest, Inc., Chicago • 454-7600

No. 80-338

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

HCSC—LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF AMICUS CURIAE OF THE AMERICAN HOSPITAL ASSOCIATION IN SUPPORT OF THE PETITION FOR CERTIORARI

INTEREST OF THE AMICUS

Amicus Curiae American Hospital Association respectfully presents this brief in support of Petitioners' request that a writ of certiorari issue from this court to review the judgment of the United States Court of Appeals for the Third Circuit in the above entitled cause.

The American Hospital Association has obtained the written consent of both the Petitioner and Respondent to the filing of this amicus curiae brief. True copies of letters evidencing such consent have been lodged with the Clerk of the Court.

The American Hospital Association (AHA) is the primary organization of hospitals and other health care institutions in the United States. It is a not-for-profit membership corporation organized under the laws of the State of Illinois. The principal corporate object of the AHA is "to promote the welfare of the public through its leadership and its assistance to its members in the provision of better health services for all people." It enjoys a federal income tax exemption under the provisions of Section 501(c)(6) of the Internal Revenue Code. Its membership includes more than 6,200 hospitals and health care institutions, as well as over 30,000 personal members.

The majority of the AHA's member hospitals and health care institutions are either tax exempt hospitals or other tax exempt health care institutions or are public institutions not subject to federal income taxation. It is highly critical to member institutions of both types, as well as in the public interest, that these institutions be permitted to obtain economies of scale through joint tax exempt efforts, consistent with their individual statuses as organizations not subject to federal income taxation. There is simply no justification for taxing a collective effort that, if individually performed, would not be subject to taxation.

This brief is submitted in the hope that it will assist the Court in deciding to grant certiorari in this case and rule on the important issue presented therein.

REASONS FOR GRANTING THE WRIT

THE COURT SHOULD DECIDE THIS CASE BECAUSE OF ITS POTENTIAL IMPACT ON THE ACHIEVEMENT OF COST-EFFECTIVE, QUALITY HEALTH CARE SERVICES THROUGHOUT THE NATION.

As the spokesman for the hospital industry, the AHA has vital interest in this litigation. AHA has an historical commitment to the principle of quality health care for hospital

patients. The AHA also recognizes that the containment of hospital costs is critical to the continued provision of quality health care by hospitals. Hence, the AHA has traditionally undertaken to reduce the cost of hospital goods and services.

More recently, the historical AHA cost containment efforts have culminated in the Voluntary Effort (VE), a nationwide, private sector program to contain the increase in health care costs. The VE was created as a coalition of major national organizations, including the AHA, American Medical Association and the Federation of American Hospitals, concerned about the cost, provision, and quality of health care services. The VE's broad coalition of hospitals, physicians, insurers and other concerned parties has made substantial strides in cost containment despite environmental and inflationary factors which tend to increase hospital costs. In support of these efforts, the AHA's Center for Multi-Hospital Systems and Shared Services Organizations (now called the Center for Multi-Institutional Arrangements) was created in 1978 to provide support in the development and promotion of multi-institutional arrangements. The increased utilization of multi-institutional arrangements have been an integral part of cost containment efforts.

The hospital industry has evolved from one in which hospitals functioned as relatively independent entities, to one in which there is an increasing variety of interdependent institutional arrangements. It has been estimated that over one-third of all hospital beds in the United States are included in multi-hospital systems. Benefits which multi-hospital systems and shared services organizations provide to participating institutions include the following: economies of scale in purchasing and operational efficiency; reduction in duplication of equipment, facilities, services and staff; improved resource allocations; improved managerial capabilities through specialized management personnel, greater accessibility and avail-

ability of services, manpower, and facilities, and increasing ability of participating institutions to compete effectively in the acquisition of capital funding for both maintenance and improvement of facilities and equipment.

One example of the benefits to hospitals of using multi-institutional arrangements is in the area of laundry services. Shared laundry services currently contribute to American hospitals by their ability to provide both quality and cost effective services. These shared laundry service arrangements are uniquely capable of responding to the specialized needs of hospitals, especially with regard to disease control, cross infection, and sterilization. Benefits offered by shared laundry services include the following: reduction in administrative and supervisory cost; decreased energy consumption; expansion of available space for patient care; and improved sanitary control. In addition, experience indicates that better health care results from the daily collection and delivery of laundry to off-premises locations.

Shared laundry services justifiably seek, and should be given, benefits of a tax exemption when they are organized to provide a necessary and essential function to the charitable efforts of tax exempt hospitals. The cost savings from these services, when augmented by savings from a tax exemption, offer tremendous support to containing the costs of providing quality health care. In some instances savings from such tax exemptions can mean the difference between cost containment or curtailment of services. If shared laundry services are not granted tax exempt status, the resulting tax burden will necessarily be passed on to member hospitals in the form of higher costs of laundry services. The higher cost must then be passed on to hospital patients or those who pay for their services.

Higher costs must even be shared by the federal government, which reimburses hospitals for their services under several programs, chief among these being Medicare and Medicaid. The Congress is also acutely sensitive to any increase in hospital costs to the general public. Administratively, the

U.S. Department of Health and Human Services (DHHS) has encouraged cost containment of Medicare and Medicaid services through multi-institutional efforts. Congress has also acted directly to encourage multi-institutional efforts through health planning legislation. Curiously, only the Internal Revenue Service (IRS) has undertaken to thwart or discourage such efforts by denying tax exemption status.

It is troubling to our industry that on the one hand the DHHS and Congress encourage hospitals to enter into those sorts of arrangements so as to cut costs, while on the other, the IRS impedes the effectiveness of such arrangements by attempting to tax them. A brief discussion of some of these cost containment efforts emphasizes the injudiciousness of denying shared laundry services tax exempt status, and the importance of prompt resolution of this issue to protect these containment efforts.

The governmental efforts in this area include the "prudent buyer principle" mandated by DHHS (formerly Department of Health, Education, and Welfare) which requires hospitals to act as "prudent and cost-conscious buyers" seeking to minimize the costs of goods and services. Provider Reimbursement Manual (P.R.M.), HIM-10, Part L, § 2103.[1] This principle is designed to encourage group or bulk purchases and economics of scale through multi-institutional efforts. Since this rule mandates that hospitals buy wisely, it encourages shared services by limiting reimbursement of costs to whatever lesser costs might have been available through group purchasing or other means.

This encouragement by DHHS of shared services arrangements to contain costs is consistent with the intent of Congress as expressed in the National Health Planning and Resources Development Act. In 42 U.S.C. § 300K-2, Congress found that shared services deserved "priority consideration in the formula-

[1] The Manual is based on 20 C.F.R. 405.451(c)(2)(ii) and 40 Fed. Reg. 51, 474 and 51, 975 (1975).

tion of national health planning goals and in the development and operation of Federal, State, and area health planning and resources development programs." In doing so, it identified as such a goal: "The development of multi-institutional arrangements for the sharing of support services necessary to all health service institutions."

Shared laundry services, such as these involved in this case, are favored by Congress as an essential part of the overall cost containment effort.

The utilization of shared services, including shared laundry services, is therefore critical to the overall cost containment efforts of both the hospital industry and the federal government. This case involves considerably more than a challenge to the tax status of one shared laundry service. This issue affects shared laundry services throughout the nation, and thus a substantial element of hospital costs. As was thoroughly discussed in the petition for certiorari, a sharp split regarding the federal income tax status of such organizations now exists between various federal courts, including those of co-equal rank.

Since the continued ability of shared laundry services to provide quality and cost effective services to hospitals is at stake in this litigation, it is of crucial importance to the hospital industry and to the public interest that the court accept the petition for certiorari. Otherwise, the uncertainty of the judicial outcome on exemption issues and the unilateral approach by the IRS will continue to hamper multi-institutional efforts that are dictated by common prudence and encouraged by both Congress and administrative agencies other than the IRS.

CONCLUSION

For the above reasons and those set forth in the Petition for Writ of Certiorari, we urge this Court to grant certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

JAY HOMER HEDGEPETH
KAREN KOPPEL KAUNITZ
840 North Lake Shore Drive
Chicago, Illinois 60611

Attorneys for Amicus Curiae
American Hospital Association